US wars have little economic impact on asset prices

Last week we argued that a US attack on Syria would have little impact on asset prices. Here we expand this analysis to consider the effect on asset prices of other recent US attacks on a foreign power. Subject to the qualifications set out below, we find that the impact of US warfare over the past twenty years has been minimal. Excluding the first Gulf War, it is almost non-existent.

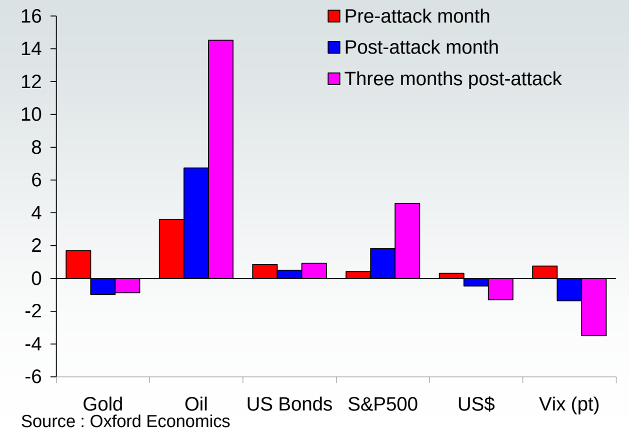
The past 20 years show little impact of war on asset prices

We believe that a western attack of Syria is unlikely to have much effect on asset prices – as long as the conflict does not escalate (see *Attack on Syria: the danger is in escalation*, 30 August 2013). Extending the analysis to US attacks that have taken place in the past twenty years shows that this has almost always been the case. With the exception of Gulf War I, it is difficult to assign much of a financial impact to acts of war. On average, there is a slight increase in volatility prior to the opening of hostilities, but this rapidly decreases once hostilities have been initiated and even more so when they are concluded. There may be some safe haven impact on the dollar initially, which is then usually reversed.

Needless to say, this statement is hedged with qualifications. First, it refers specifically to asset prices. Second, it is based on a fairly small sample. We have looked at the change in asset prices around the time of five US or US-led attacks on other countries over the past twenty years: Gulf War I in 1991; Bosnia in 1995; Kosovo in 1999, Afghanistan in 2001 and Gulf War II in 2003. These have been chosen because they were widely anticipated, so asset prices had time to react. By contrast, incidents where an occasional American cruise missile was launched against Iraq or Somalia have not been included. Third, we have only looked at changes in asset prices up to one month before the initiation of hostilities; as well as one month and three months after hostilities began. This relatively short time period was chosen because a longer period is more likely to be distorted by other events. In the case of the attack on Afghanistan, even one month before the campaign began asset prices were severely distorted by the terrorist attack on the World Trade Centre. Fourth, we have only looked at five assets, gold, oil

Asset class price impact: average of conflicts

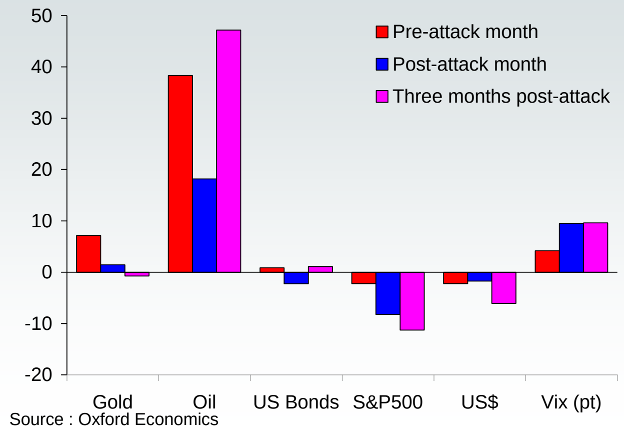
% change (unless otherwise stated)



Source : Oxford Economics

Asset class price impact: Gulf War I

% change (unless otherwise stated)



Source : Oxford Economics

(WTI), the 10-year US Treasury (total returns), the S&P500 and the dollar (Federal Reserve nominal trade-weighted index). In addition, we have looked at the Vix index to illustrate volatility. Fifth, we assume that changes of less than 5% are insignificant.

The first Gulf War was an outlier

Looking at the average of all five conflicts, it is immediately apparent that asset prices very rarely move by more than a few percentage points over any of the periods. Only in three cases do we find a significant impact. One is oil, where the price shifted little on average in the period immediately before and after hostilities began, but then on average rose by 14.5% over the three months after an attack. However, this is above all due to Gulf War I, when oil prices rose by close to 50% in the first three months after the war began. Stripping out that conflict would reduce the average oil price change three months after an attack to 6.4%.

Gulf War I was also the conflict that saw the largest negative impact on equity prices, and the greatest rise in volatility. Equities fell 2.2% in the month before the war began, a further 8.2% in the first month after the attack and a total of more than 11% over the three months following the attack. That is not surprising, and most likely related to the rising oil price.

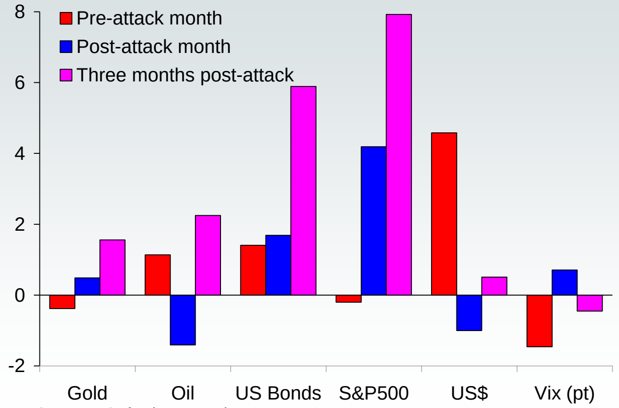
Bosnia, Afghanistan, were irrelevant to asset prices; Kosovo seems peculiar

By contrast, the conflicts in Bosnia and Afghanistan seem almost wholly irrelevant to asset price developments. However, it is difficult to interpret the numbers relating to the 2001 Afghan campaign since the 11 September attack on the World Trade Center occurred within the timespan studied (the campaign began on 7 October 2001, just under a month after the terrorist attack).

Neither gold nor oil were particularly affected by the air strikes in Bosnia. There was a brief burst of volatility in the immediate aftermath of the attack, but the main asset price developments after the war were a rise in US share and bond prices and a minimal rise in the dollar.

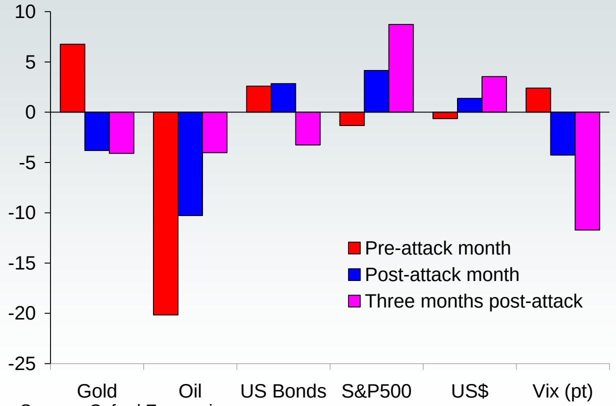
The Afghan campaign was preceded and accompanied by falling oil prices. Gold also fell after the attack. However, since the bulk of these changes occurred in the month before the campaign began, it is more likely that they were related to the 9/11 attacks that prompted the retaliation in Afghanistan. This is probably also the reason for the 9% rise in share prices and a sharp fall in volatility in the following three months.

Asset class price impact: Bosnia
% change (unless otherwise stated)



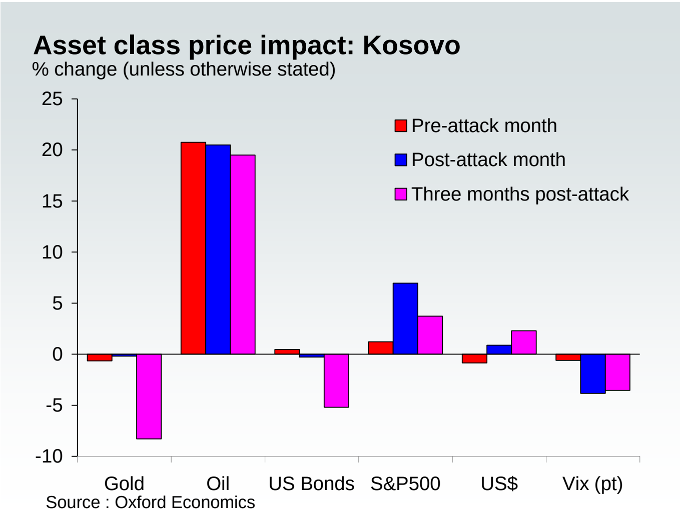
Source : Oxford Economics

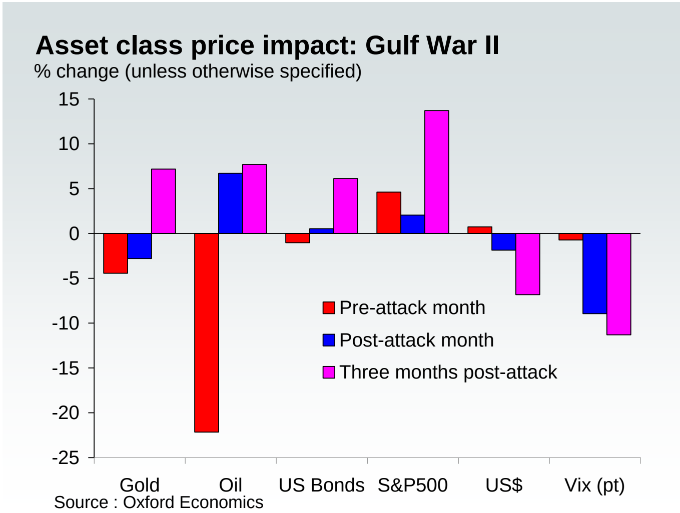
Asset class price impact: Afganistan
% change (unless otherwise specified)



Source : Oxford Economics

By contrast, the Kosovo campaign in early 1999 was associated with substantial shifts in asset prices. Oil prices rose by approximately 20% both before and after the bombing began, and treasury yields surged afterwards, pushing bond prices down. But gold and share prices were relatively unchanged, suggesting that oil prices may have moved for some other reason; as indeed they did. OPEC, concerned about low oil prices (in the second half of 1998 the WTI price averaged less than US$13.50/bbl) implemented a series of quota cuts in early 1999, which eventually raised the price to US$26 by the end of the year.





Gulf War II had less effect than Gulf War I

Gulf War II had more of an impact on asset prices. Not so much prior to its beginning, when oil, gold and Treasuries all fell and US equities edged up. But once the war began, and particularly once the initial fighting was effectively over, all assets improved with the exception of the dollar (presumably a reversal of safe haven flows); and volatility fell. Even though the changes were significant, they were much less marked than during Gulf War I.

Lessons to be learned

The five conflicts covered here differ enough that some conclusions can be drawn from them. First, the impact on asset prices was greater in connection with Gulf Wars I and II. That is likely to be because these were ‘conventional wars’, involving ground forces. The Bosnian and Kosovo campaigns did not involve ‘boots on the ground’, nor did the Afghanistan campaign (at least initially) with the exception of some US Special Forces. Second, when the perception is of an enemy that lacks any significant capacity to strike back – a perception in force prior to all campaigns except Gulf War I – the impact on asset prices is again minimal. And, third, even when a campaign involves a major oil producer, the experience of Gulf War II shows that the impact on oil prices need not be particularly large.

Assuming these conclusions hold true, what do they augur for an attack on Syria? There will be no involvement of ground forces; Syria lacks the capacity to respond in any major way (although there is always the risk of terror attacks using Syria’s Iranian or Hezbollah allies); and the country is not a major oil producer. So unless the conflict escalates, pulling in other countries, the asset price impact of an attack on Syria is likely to be minimal.

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